Process and issues paper for determining a TSLRIC UBA price

Submission | Commerce Commission

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Introduction

1. Thank you for the opportunity to provide comments on the Commission's proposed approach to the UBA final pricing principle review. The Commission's issues and process paper (**the Commission's paper**) sets out the proposed timetable, modern equivalent asset (MEA) to be used when modelling UBA costs and process for obtaining information from the parties.

2. The Commission is also considering final pricing principle applications for the designated UCLL service and seeking cross submissions on the corresponding UCLL processes and issues paper by 28 February 2014. We agree, as noted by the Commission in the UBA paper, that there are strong linkages between the UBA and UCLL price review determinations.

3. We made extensive submissions in our submission on the UCLL FPP process which are germane to the approach to the UBA FPP process. We do not repeat those here, but refer the Commission to the more general aspects of our UCLL FPP submission on the selection of the MEA and the linkage between section 18 and underlying economic rationale for use of a FPP process based on TSLRIC as defined in the Act.

4. A range of services are provided over the local access network and it's important that the UBA and UCLL cost models reconcile so that there is no under or over recovery of costs. For example, the local access and transport networks share elements such as ducts and these costs will need to be shared between services. Ideally, the UBA and UCLL processes would run in parallel to the greatest degree possible, drawing on the same input data where relevant, and brought together at key decision points. For example, at the time the cost model principles and specifications are agreed.

5. In this submission we address the timetable, MEA and process issues set out in the Commission's paper in light of the linkages between the UBA and UCLL processes.

The Commission should be alive to the risk that an aggressive timetable undermines the robustness of the FPP process

6. The Commission's proposed timetable is designed to complete the UBA price review determination prior to December 2014. While we appreciate the Commission must make reasonable efforts to complete the review within 3 years of separation day, the Commission's priority must be to achieve a high-quality and robust FPP price for the UBA service that will endure over a reasonable period. Speed of answer should not detract from this objective.

7. As set out in our comments on the applications, if the Commission wants to provide a transparent estimate of the time this FPP review will likely take, we believe that completing the UBA FPP within two years would be reasonable. The Commission has proposed an aggressive timetable and should ensure that, as the process unfolds, adherence to the proposed timetable doesn't undermine the robustness of the FPP estimate.

An appropriate balancing of trade offs

8. We agree that the Commission must balance various tensions when undertaking an FPP. For example, at some stage through a process the incremental benefits of added accuracy are outweighed by further delay.

9. The UBA price will have a significant impact on the New Zealand market and consumers. For example, the UBA price is paid to Chorus on about one million lines, affects the business case for unbundling and consumers purchasing decisions. The Productivity Commission has identified a clear link between broadband price and GDP. It is therefore clearly important to considerations of efficiency and total utility that the Commission sets an efficient and robust FPP price, and takes whatever time is necessary to do this.

10. Conversely, as noted in the paper, the potential scope of an FPP review inevitably results in uncertainty for the market. It is difficult for operators to make long term decisions and commitments without UBA prices being finalised. Knowledge and certainty of the regulated price is crucial to current and future investment and competitive decisions.

11. The Commission has yet to consider key principles and requirements that underpin UBA cost model and these will determine, amongst other things, whether the proposed timetable is achievable. Accordingly, the Commission should ensure that, as the process unfolds, it retains the option of extending this process if that process necessary to ensure a robust answer is found.

Reasonable efforts and FPP objectives

12. It is open to the Commission to take a longer period (two years) to finalise the UBA FPP price. It is equally open to the Commission to take a shorter period if that proves feasible.

13. The Commission is required to make reasonable efforts to complete the FPP within three years of separation. However, when read in the context of the obligation to complete an IPP review within one year of separation, this suggests two years is considered a reasonable period to complete the FPP process.

14. Again, as set out in our comments on applications, Section 77(1)(a) of the Telecommunications (TSO, Broadband and Other Matters) Amendment Act 2011 provides that the Commission make reasonable efforts to review the UBA STD in order to make changes necessary to implement the initial and final pricing principles applicable after the expiry of 3 years from separation. At a minimum this would require the Commission to set an IPP price and amend the STD to permit the final pricing principle to be implemented. We do not consider this obligation requires the Commission to actually strike an FPP price within that time though. Reasonable efforts are likely to have been exhausted when the Commission finalised its UBA pricing review. The STD had by then been reviewed and necessary changes made such that the initial and final pricing principles can be implemented.

The UBA service

15. The Commission proposes to consider the UBA service as a layer 2 bitstream service provided over Chorus' local loop network. Further, the UBA MEA would be considered in light of a hypothetical new entrant to seeking to compete with Chorus' UBA service. The implication being that the new entrant provider would utilise the currently available layer 1 inputs and this results in a practical constraint on the UBA MEA, and the degree of network optimisation possible.

Additional UBA costs incurred

16. We agree that Commission should consider UBA incremental to the local loop network. This is consistent with the UBA pricing principle whereby the Commission must identify the additional TSLRIC costs of providing the UBA service.

> *The price for Chorus's unbundled copper local loop network plus TSLRIC of additional costs incurred in providing the unbundled bitstream access service*

17. This approach also reflects officials recommended cost-building block (the total UBA cost derived by building on existing cost-based UCLL prices) and is consistent with the IPP benchmark cost models and forward looking MEA models implemented overseas.[1] For example, the benchmark cost models used to set current UBA prices recover the whole-of-access costs from UCLL services, with the bitstream costs comprising electronics and transport from the local exchange to the hand over point. Aligning the FPP assumptions to those used for setting IPP prices also minimises price changes due to shifting costs between local access and UBA services (albeit this is of limited effect as any UBA price change would likely lead to a countervailing adjustment in the UCLL service. Accordingly, this is unlikely to result in any real change to the combined UCLL plus UBA price).

18. However, the Commission should seek to model the costs of a hypothetical efficient provider and the degree to which service can assumed to be based on the existing layer 1 services will depend on the Commission's UCLL price review approach.

The efficient TSLRIC provider

19. The Commission has proposed to base the model on the costs of a new entrant. However, as discussed more fully in our UCLL issues and processes submission, the forward looking TSLRIC standard required by the Act is based on efficient costs. These costs are not necessarily those of a new entrant or access provider, but a hypothetical efficient provider.

20. Further, the cost modelling should recognise that some reused assets are unlikely to be replaced or replicated. Accordingly, the Commission should estimate the costs of an efficient provider building a modern network that recognises reuse of these assets. This approach provides the

[1] See RIS provided to select committee http://www.parliament.nz/resource/0000171267 at para 29.

efficient pricing signals that deliver the desired FPP outcomes. It's also consistent with the approach being taken by overseas regulators and affirmed by the High Court in the Part IV input methodologies process.

21. In terms of electronics related costs, there may be little practical difference between an efficient new entrant and hypothetical provider's costs since both would make capital investments in current technologies for the provision of bitstream services. In addition, we believe that the use of appropriate modern equivalent assets in the electronics required to support the UBA service would likely result in significant simplification of the network architecture currently deployed in New Zealand. We comment further below on this point in relation to optimisation.

22. For example, at an engineering level, the UBA transport costs from the local exchange to the first data switch likely has two components; the capacity costs of backhaul provisioning dependent on engineering choices, and the level of possible aggregation of traffic, and distances to the first data switch.

23. However, there may be material differences relating to:

    a. The degree to which transport capability relies on reused assets such as ducts. These should be reflected in an efficient providers transport costs; and

    b. Optimisation of DSLAM equipment placement in the network. To base equipment locations on all the existing nodes will embed current inefficiencies in the UBA cost estimate. It's unclear how significant potential node optimisation is.

24. Further, substantive efficiencies can be achieved through optimised placement of DSLAM equipment. As noted in paragraphs 94 and 95 of Telecom's UCLL FPP submission, the degree of urbanisation in New Zealand means that some 86% of the population occupies less than 3% of the useable land area with average urbanised area population densities ranging between approximately 250 and 580 people per km^2. The implication of this is clear for the economics of UBA.

25. While the actual outcomes would be dependent on the actual UBA FPP cost model ultimately adopted by the Commission, the optimised placement of modern DSLAM equipment within the network could result in as many as 40% of broadband capable lines being collocated with the first data switch (with only electronics costs and no additional transport costs), while approximately the next 50% of those lines would be located within say 25 km of the first data switch by cable distance.

Linkages with the UCLL pricing review

26. The practical differences between new entrant and efficient provider and model complexity will depend, in part, on whether the Commission decides to unpick the current full local network cost approach to setting UCLL prices.

27. In the UCLL FPP the Commission faces a choice relating to whether or not to disaggregate the costs of the local network into different UCLL, UCLL and conceivably UBA local access network uplift prices. If the Commission were to maintain the current whole-of-network approach for

UCLL this would reduce the complexity of UBA modelling. For example, the Commission could avoid assessing and allocating local access costs, likely limiting UBA modelling to electronics and transport from the local exchange to the first data switch.

28. Alternatively, UBA modelling becomes more complex with a disaggregated UCLL approach. The price for Chorus's unbundled copper local loop would only capture a subset of local access network costs. Whether, and if so how, the residual costs would be captured in some other price, including the UBA price, is not at all clear. However, the Commission would be obliged in that scenario to consider whether some or all of these costs are caught by the UBA pricing principle, and therefore recoverable through the UBA price. Accordingly, the UBA model would need to be more sophisticated and complex, and have stronger linkages with the UCLL model.

29. While the Commission could complete the UBA FPP on its current proposed timeline and leave resolution of the disaggregation issue to the UCLL process, this would require it to subsequently review and adjust UBA prices at the time the UCLL pricing process is completed.

Information requests

30. We support the Commission plans to issue compulsory information requests to Chorus and other industry participants. The Commission is required to identify efficient costs and should draw on information from a number of sources to understand these costs.

31. Appropriate safeguards of commercially sensitive information should be coupled with sensible access by professional advisers to enable parties to participate in a meaningful way.